

HEARING DRAFT

**HEADWATERS FUND
ALTERNATIVES REPORT**

April 2002

**County of Humboldt
Community Development Services
Economic Development Division**

with contributions from:

Williams-Kuebelbeck & Associates, Inc.
Real Estate Economic, Financial and Management Consultants

TABLE OF CONTENTS

EXECUTIVE SUMMARY iii

SECTION 1: HEADWATERS FUND 1

SECTION 2: PUBLIC INPUT PROCESS 2

SECTION 3: SUMMARY OF COMMENTS RECEIVED 3

Management of the Fund 3

Criteria for Decision Making 4

Investment Opportunities 5

Response to Comments on the Discussion Draft 7

SECTION 4: FUND ALTERNATIVES 10

Goals 11

Control and Oversight 13

Staffing 14

Financial Management 15

Community Investment Opportunities 16

Name 18

SECTION 5: PROPOSED CHARTER 19

Name 19

Goals 19

Control, Oversight and Staffing 19

Financial Management 22

Revisions, Amendments and Variances 23

Community Investment Opportunities 23

Revolving Loan Fund 24

Investment Fund 26

Grant Fund 30

SECTION 6: ILLUSTRATIVE PORTFOLIO 34

APPENDIX

I) Memorandum of Understanding - County of Humboldt, et al.

II) Headwaters Fund Revenue and Expenses To-Date

III) Comments From Public Meetings

IV) List of Community Members Interviewed

V) Written Comments

VI) Prosperity! The North Coast Strategy

VII) Timber Yield Tax Loss Estimates

VIII) Maintaining Access to Low Cost Borrowing Programs (TRANS)

IX) Review of Economic Adjustment Funding Pools

X) Asset Management Definitions and Concepts

XI) Potential Funding and Implementation Partners

XII) Venture Capital Programs

EXECUTIVE SUMMARY

In 1999, the County of Humboldt received \$22 million dollars from the state and federal government to mitigate the economic impacts of the sale and preservation of the Headwaters Forest. The Board of Supervisors, through a Board appointed sub-committee consisting of Supervisors Bonnie Neely and John Woolley, the County Administrative Officer and staff of the Community Development Services Department, has worked with the public to develop alternatives for managing the funds. The primary goal was to develop a decision-making process that in the long run would result in the money being used for the highest and best purposes in the community. This report presents the results of this work.

The report recommends the creation of a permanent “Headwaters Fund” to help grow and diversify the economy. The Board of Supervisors, working through County staff and a Headwaters Fund Board, would manage the funds consistent with the rules and bylaws of an adopted Charter. A portion of the funds would be made available to local businesses through a “Revolving Loan Fund.” Another portion of the funds would be dedicated to an “Investment Fund” for projects that provide permanent economic benefits, such as public facility infrastructure or sustainable endowments. The interest earnings from the Fund’s principal and earnings from the Revolving Loan Fund would be used to sustain a local “Grant Fund” for economic and community development projects.

The Revolving Loan Fund would be managed by existing business loan providers. County staff in the Community Development Services Department would administer the Investment and Grant Fund programs. The Headwaters Fund Board, consisting of nine community members, would review and rank projects against established project selection criteria and make funding recommendations to the Board of Supervisors.

Project selection criteria would promote the funding of projects that further the County’s Comprehensive Economic Development Strategy currently known as “Prosperity! The North Coast Strategy.” An overriding criterion, designed to extend the benefits of the Headwaters Fund, will be the ability of businesses and projects to match the Headwaters Fund contribution with other private and public contributions.

The Funds activities and performance will be publicized in annual reports to the community. Every three years, the Fund Charter will be reviewed and updated through a public process.

This “Hearing Draft” is a revised version of the “Discussion Draft” dated November 2001. Significant revisions to the report prompted by public comments are summarized in the section beginning on page 7.

The Board of Supervisors will consider the recommendations of this report in meetings open to the public. Written comments on the report and attendance at the meetings are strongly encouraged.

SECTION 1: HEADWATERS FUND

In 1999, the state and federal governments purchased the 3000-acre old-growth Headwaters grove. While this landmark acquisition preserved internationally significant forest habitat, it also removed significant timber resources from Humboldt County's economy.

Leading up to the sale, local officials and community leaders argued that the Headwaters acquisition should include an appropriation to offset local economic losses. A July 1997, resolution of the Board of Supervisors, supported by a Memorandum of Understanding between the County of Humboldt, the City of Eureka, the Humboldt Bay Harbor, Recreation and Conservation District, and the Northwestern Pacific Railroad requested a \$118 million mitigation package (see Appendix I for the MOU). This local effort, combined with the work of Humboldt County's legislators, resulted in a combined \$22 million state and federal appropriation to the County of Humboldt.

The state share of \$12 million was earmarked for "economic assistance." The \$10 million federal share was termed a "direct payment" to Humboldt County. Congressman Mike Thompson and Assemblywoman Virginia Strom-Martin worked to secure the funds. Governor Gray Davis and others presented the checks to the Board of Supervisors in a courthouse ceremony.

On October 19, 1999, following a recommendation from a Board of Supervisors subcommittee consisting of Supervisors Neely and Woolley, the full Board voted to reserve the bulk of the funds for the "economic prosperity and quality of life for all Humboldt County residents." They approved using a fraction of the funds to offset certain County costs directly related to the Headwaters acquisition (see Appendix II for details).

The Board further instructed staff of the Community Development Services Department to work with citizens and organizations to develop recommendations for the long-term management and use of the funds.

This report presents the results of this Board directed outreach and research effort. It provides background on the Headwaters Fund, summarizes the results of the public process and research activities and outlines the major alternatives available to the Board.

With accumulated interest less expenditures, the Headwaters Fund now stands at \$23.5 million. While this is a significant amount of money, it pales in comparison to the economic, social and environmental needs of the County. To obtain tangible benefits, the funds must be used selectively and strategically.

The purpose of the report and the public input is to recommend a process that will yield sound investment decisions responsive to the needs of the community over the long run. It is not to recommend specific projects for funding.

A Discussion Draft of this report was released in November 2001 and presented in a public workshop in Eureka on December 11, 2001. This Hearing Draft has been revised based on the input received on the Discussion Draft (see Section 3 for a description of the revisions). Following public review and comment on this Hearing Draft, the Board will conduct meetings to receive input, deliberate and choose fund alternatives. These meetings will be advertised to the general public. Requests for notification of meetings and written comments on this report (deadline April 26, 2002) can be submitted to:

Community Development Services
Economic Development Division
520 E Street
Eureka, CA 95501
Jdebets@co.humboldt.ca.us

A Charter, reflecting the Board's choice of fund alternatives, will be prepared for final Board adoption. The Charter will include a description of the Fund's goals, investment strategy and criteria for evaluating proposals. It will also outline the administrative process for fund management, decisionmaking and Charter amendments.

SECTION 2: PUBLIC INPUT PROCESS

On July 18, 2000, the Board of Supervisors approved a plan to conduct public outreach. Five public meetings were held at different locations in the County during September 2000. At those meetings, over 300 individuals provided input on the use of the Headwaters Fund (see Appendix III for a summary of comments).

These public meeting were followed by formal and informal interviews of individuals having specific expertise or representing specific areas of interests (see Appendix IV for a list of those interviewed). The interviews sought more in-depth comments on topics raised in the initial round of public input.

In addition to public meetings and interviews, numerous organizations and individuals have submitted written comments (see Appendix V).

The firm of Williams-Kuebelbeck & Associates, an economic and financial consulting firm, was hired to assist County staff in the analysis of public input and the development of fund alternatives.

The County also retained the law firm of Stradling, Yocca, Carlson & Rauth, specifically the services of Carol Lew, Esq., to advise the Board on alternatives as they relate to the County's eligibility to secure low-interest financing through Tax and Revenue Anticipation Notes (TRANS).

A Discussion Draft of this report was released for public review. Input was solicited through a public workshop and a request for written comments. The input received was incorporated in this Hearing Draft version of the report that the Board of Supervisor's will consider in open public meetings. The written comments have been included in Appendix V. A partial response to the comments received is provided in Section 3.

The Board's votes on the various Fund alternatives will provide direction for drafting the final Fund Charter. The Fund Charter will be brought back to the Board at a later meeting for final adoption.

SECTION 3: SUMMARY OF COMMENTS RECEIVED

The second phase of the Public Input Process, as described above, consisted of a series of interviews with community stakeholders. The interviewees were selected for their knowledge of the community or of fund management issues. Community Economic Development staff and the consultant conducted most of the interviews. County staff conducted further follow up interviews to flesh out details and clarify points.

The public meetings, written comments and interviews covered a wide range of issues. A brief synopsis of the general themes that emerged from the input, arranged by subject follows. There was general agreement on most of these issues. Where a significant minority opinion was expressed, it is noted.

This section also includes a response to comments on the report's Discussion Draft.

COMMENTS on the MANAGEMENT of the FUND

There was near unanimous opinion that the use of the Headwater Funds should be determined on a rational and managed basis to achieve specified goals, in order to avoid a continuous political battle over the use of the funds. People felt the Board of Supervisors should have the ultimate responsibility for the funds, but day-to-day management and investment decisions should be guided by social, economic, and planning policies.

The majority of people interviewed felt that the principal amount of the Headwaters Fund should be preserved to the greatest extent possible. There were differences of opinion on how to do this, but in general, there was agreement that project grants should be made only from the interest (earnings) of the fund. There was a broad sense that the funds should be preserved for future generations. Also it was recognized that there might not be sufficient opportunities that will actually create jobs now from a large one-time grant.

At the same time, most agreed it is better to maximize local investment of principal, through loans or other vehicles. In so doing, the principal is available for local business expansion and organizational development and creates earnings. Some objected to preserving the principal, stating that investments in standard financial instruments will earn interest but the capital is not creating public benefits locally.

There was also concern that the funds not be spent on one big project that might not be successful. Generally, people espoused the principle of diversification, although there was no consensus on how to accomplish this.

Most interviewees agreed that, to the greatest extent possible, the funds should be leveraged with other funds. This would mean a preference for matching grants and loans where other sources of funds are also invested. Of course, this approach could increase the impact of the Headwater Funds.

Generally, there was concern that Headwaters Funds be managed efficiently and directed to those projects with the greatest likelihood of producing the intended results. Many cited the Option 9 process as one example of how funds were not well directed. Generally, people expressed the impression that too much of these funds went to small risky projects that did not materialize. Also too much of the funds were spent on planning and feasibility studies rather than on projects on the ground. Likewise, the economic adjustment funds received from the creation of the National Redwood Forest were perceived as being only partly effective. Some of the infrastructure projects were considered useful, however the direct grants to individuals were not. Comments on the Option 9 process were anecdotal in nature and were not the product of a formal evaluation of the program.

Numerous financing vehicles were discussed including: revolving loan funds, matching grants, equity investment, venture capital funds, project grants, etc. There was no consensus on which vehicles to focus on or the proportion of funds to dedicate to each.

COMMENTS on CRITERIA for DECISION MAKING

There was a near unanimous opinion that the Headwaters Funds should be used to improve the economy and to most this meant creating new jobs. People acknowledged that there are many needs in the County and many “worthwhile” projects, but maintained that the emphasis of the Headwaters Fund should be on long-term jobs with good wages and benefits.

Most stated that the general principles and directions of the County’s current Comprehensive Economic Development Strategy, known as “Prosperity! The North Coast Strategy,” would be a good starting point for establishing criteria for selecting projects. To many, this meant a focus on base industry clusters, and on natural resource based industries.

Many expressed the need to be highly selective and conservative in decisionmaking. Most wanted projects to have a "tangible result", which generally meant jobs, facilities, or some measurable impact.

It was recognized that there are "social programs" which provide a community wide benefit that is difficult to measure, but most felt that grants to these programs should be limited to matching grants, in order to best leverage the funds impact on the economy.

There was some interest in establishing a "fair" allocation that would seek to target those areas hardest hit, or most in need, but generally this was less important than selecting good projects that will make a difference on a regional basis. Some advised that there should not be a quota to fund a certain number of projects, but rather a focus on fewer projects with greater community-wide support.

Some felt that the Board of Supervisor's should honor the terms of the 1997, Headwaters Memorandum of Understanding between the County of Humboldt, the City of Eureka, the Humboldt Bay Harbor, Recreation and Conservation District, and the Northwestern Pacific Railroad. The MOU included five potential areas of investment: 1) infrastructure; 2) watershed rehabilitation; 3) Humboldt Bay Harbor District's Capital Improvement Plan and County of Humboldt Overall Economic Development Plan; 4) public services and infrastructure; and 5) worker re-training. The Board of Supervisors acted on the issue of adherence to the MOU on October 19, 1999. The Board directed staff to review these investments and include the consideration of these areas into the larger public process.

COMMENTS on COMMUNITY INVESTMENT OPPORTUNITIES

Discussion about areas of investment opportunity ranged from specific projects to goal based investment. Three major areas of opportunity that emerged from public input were gap financing for local business expansion, financing for community projects and matching funds to leverage additional state, federal and private grant money.

Overall, business lenders expressed confidence that there is enough capital available in the local market for standard business lending. However, lenders pointed to specific gaps that were barriers to business growth:

- Venture capital (equity investment with a higher risk and can provide a higher return)
- Loan guarantees to replace collateral (fill gap between 70% and 90% of loan to value)
- Commercial real estate loans with higher loan to value ratio
- Product research and development for business expansion
- Higher risk, subordinate loans
- Loans of larger amounts (over \$300,000)

Non-profits, government jurisdictions, foundations, and community service organizations identified several gaps in financing for community projects:

- Cash-flow loans for covering periods between billing and receiving reimbursement from government grants (can be 6 months between expense and reimbursement).
- Pre-development loans for permitting or other studies required prior to grant or loan acquisition.
- Loans to match state and federal housing loan programs.
- Loans for public water, wastewater, and drainage improvements to compliment state and federal loan programs.
- Loans for non-profit community organizations to purchase or renovate buildings.

- Loans for low-income persons to buy cars for transportation to work or to purchase a home.
- Bridge loans to purchase land or conservation easements between initial purchase and transfer to ultimate owner.

Many commented on the need for additional grant funds for various sectors. People were interviewed to identify gaps in grant funding and unrealized leveraging opportunities that would bring additional grant money into the community. These significant gaps were described:

- Pre-project grants for permitting or other studies that would enable applications for larger project grants.
- Cash match to enable eligibility or increased competitiveness for state, federal or foundation grant funds.

There were several large infrastructure projects throughout the region that were recommended for funding: railroad line and facility upgrades, public marine terminal, airport runway extension, Highway 101 improvements to accommodate large trucks and an industrial park. Many people expressed that the amount of funds available from the Headwaters Funds would probably not be able to bring about any of these very large projects alone. However targeted and leveraged investments in infrastructure projects that would have significant positive economic impacts should be considered. Among those mentioned, expansion of the airport, increasing the amount of industrial land available, and specific facility projects for industrial development had a broader base of support.

There was considerable support for forest and watershed restoration projects. However, many felt that they should be evaluated on the same basis as other investments. People generally recognized the social and environmental benefits of these projects in that they increase the social and environmental “capital” of the area. They also add to the financial capital of the area by stimulating natural resource based industry clusters. Land purchases were also mentioned either as a possible investment or for natural resource preservation or both, suggesting management like the Arcata Community Forest.

While many members of the public did not want regular government services to be funded from Headwaters Fund, programs and projects that needed match dollars to bring in significant grants were identified as valuable. Government programs should compete and be judged just like any other project. Additionally, the programs should not be a general-purpose operations of government (e.g., roads, public safety, regulatory permitting) with access to other government funding.

Business leaders, lenders and educators all identified education and training as an area of great need in the region. Business expansion may depend upon a combination of financial capital and entrepreneurial training and skill development in the local workforce. Training programs should focus on developing business management skills, entrepreneurial drive and creativity, professional development for the already employed, as well as basic work skills and ethics, and specific skills for workers needed in industry

clusters. People referenced existing local resources that could be enhanced with Headwaters Funds.

RESPONSE TO COMMENTS on the DISCUSSION DRAFT

The Discussion Draft of this report was released in November 2001, and presented in a public workshop in Eureka on December 11, 2001. Comments received at the workshop and written comments submitted after the workshop are included in Appendix III and V. Notable revisions to the Discussion Draft include:

- Staff has changed its recommendation for the name of the fund from “Prosperity Fund” to “Headwaters Fund.” The name “Headwaters Fund” enjoyed overwhelming support by those that attended the Discussion Draft public workshop. (See page 18)
- Staff is recommending three approaches to increase the local availability of venture capital: 1) Include loans with equity characteristics in the range of loan products available through the proposed Revolving Loan Fund (RLF) program, 2) investigate the possibility of forming an affiliation with an existing community development venture capital fund, 3) work to develop the support systems for an entrepreneurial economy to increase the number of companies that would benefit from infusions of venture capital. (See page 25 and Appendix XII)
- This report clarifies the eligibility of watershed and environmental restoration projects for the Headwaters Investment Fund. While staff maintains its recommendation that candidate Investment Fund projects must have positive economic impacts, this report now explicitly states that watershed and environmental restoration could be funded on this basis under several lines of reasoning. Research conducted for Prosperity indicates that many business owners are located in Humboldt and many tourists visit Humboldt because of the quality of our environment. A healthy environment can be viewed as a local business asset. Additionally, there can be direct economic impacts in the expansion of the growing watershed and environmental restoration industry and long-range economic benefits to fisheries and timber production. (See page 26)
- This report now includes a description of a process for periodic updates and revisions to the Headwaters Fund Charter on aspects such as target investment levels and Fund goals. It also includes a process for granting exceptions to the Headwaters Fund guidelines for projects that offer extraordinary benefits. These proposed changes are intended to increase the overall flexibility of the Fund. (See page 23)
- Changes were made to the preliminary ranking criteria for “Overall Project Benefits” and the point totals possible within benefit categories for the Investment and Grant Fund. (See pages 27 and 31)

- The report clarifies that the Headwaters Fund Board and the Board of Supervisors will further refine the ranking criteria for project selection. The process will be open to public and begin as soon as the Headwaters Fund Board is selected. (See page 26)
- The list of “Potential Funding and Implementation Partners” has been expanded. (See appendix XI)
- The recommendation for the amount of money paid from the Headwaters Fund to the County to compensate for Timber Yield Tax losses has been adjusted from \$250,000 to the \$308,711 per year for thirteen years to reflect actual losses as estimated by the County Auditor. The Headwaters Subcommittee of the Board of Supervisors is recommending to the full Board that this increase to the County be used to partially fund the administrative expenses of the County Economic Development Division. In the past two fiscal years, these expenses were charged to the Headwaters Fund. In the future they will not be charged to the Headwaters Fund and will be borne by the County General Fund. This will segregate the ongoing funding of County operations from the finances of the Headwaters program. (See pages 35 and 36)
- The recommended annual set-aside to offset inflation losses has been reduced from 1.5% to 1.0% of the fund. This reduction offsets the increased contribution to the County for Timber Yield Taxes losses. Without this offset, the money available for the annual grants program falls below \$300,000 per year. This funding level is considered a minimum threshold for financial viability. The set-aside will be re-evaluated in future years in an effort to increase the amount to fully offset inflationary affects. It is anticipated that it could be fully restored once the Headwaters Fund has fully paid for Timber Yield Tax losses. (See pages 35 and 36)
- The estimate of the Revolving Loan Fund annual loss rate has been increased from 1% to 2%. The estimated annual operating expenses have been reduced from 30% to 20%. (See pages 35 and 36)
- The recommend allocation of funds between the Liquidity Fund, Revolving Loan Fund and Investment Fund has been more fully discussed. The amount of funds made available to the Revolving Loan Fund has been expressed as a “target” or goal to be reached. The Revolving Loan Fund can help to create jobs and generate a return on investment to be used in the Grant Fund. Staff believes that the amount of funds committed to the Revolving Loan Fund should be maximized because of this “double bottom line” affect. The amount of funds made available to the Investment Fund is expressed as a cap. Staff believes the current cap strikes the appropriate balance between the capacity of the Investment Fund to be a catalyst for infrastructure development and the need to maintain the viability of a long-term Grant Fund. Staff recognizes that a compelling opportunity may arise that would make it appropriate to lift the cap and has recommended that this flexibility be included in the program. (See pages 17 and 23)

- The report has been revised to clarify that the Revolving Loan Program would be administered by existing lending agencies and would not require the creation of a new bureaucracy. (See page 25)
- The Board of Supervisors has been given the direct responsibility for controlling the administrative expenses of the Fund and capping overall and annual spending limits. (See page 35)
- The report clarifies that goals of the Headwaters Fund should be consistent with the values, principles and strategies of the County Comprehensive Economic Development Strategy (CEDS). Currently the adopted CEDS is Prosperity! The North Coast Strategy. (See pages 11, 12 and 19)
- Headwaters Fund staff will screen Investment Fund and Grant Fund applications using application-screening criteria adopted by the Board of Supervisors. (See pages 26 and 30)

Staff received a number of other comments that did not prompt changes in the report but raise questions that merit further review by the Board of Supervisors:

- Should the Fund target needs that are not met with existing sources of funding instead of focusing on matching, leveraging and catalytic opportunities? Staff believes that economic restructuring can best be accomplished by focusing on highest and best opportunities supported by other private and public entities.
- Should the Fund have specific criteria to ensure that the funding is distributed geographically throughout the County and to populations with special needs? Should Fund investments be required to qualify as “socially responsible” investments? Staff considers that the proposed programs adherence to the values, principles and goals of Prosperity! The North Coast Strategy will be sufficient to include considerations of social equity.
- Should all of the principal be spent immediately on near term opportunities instead of being used as an endowment for opportunities over the long term? Staff feels a proper balance between the two extremes has been reached in the recommended program. The Revolving Loan Fund and the Investment Fund represent potential for immediate investment in the local economy. The Grant Fund, endowed by the Revolving Loan Fund and the Liquidity Fund, provides capacity to diversify and leverage investment in the economy over the long-term.
- Is it possible to secure a higher rate of return on the Liquidity Fund than standard public investment instruments offer? Staff believes this issue deserves further analysis as the Fund is created.

- Does the proposed Charter provide sufficient opportunity for watershed and environmental restoration projects? A large number of people would like to see the Headwaters Fund invested in environmental mitigation as much, if not more, than economic mitigation. Staff is recommending that environmental restoration projects that can be justified for their objective economic benefits should be considered. This strict and limited view of environmental restoration appears consistent with the original intent of the Headwaters Funds and the opinion of other members of the public. The purchase of the Headwaters Forest ranks as one of the most significant conservation projects undertaken on the North Coast. The Headwaters Funds were allocated to mitigate the direct impacts of this conservation project on the economy in ways that can be measured in objective economic terms.
- Is there sufficient opportunity for the funding of social programs? Prosperity! The North Coast Strategy identifies the clear nexus between social wellbeing and a healthy economy. Under the proposed Charter, applicants for Investment or Grant Funds would be asked to argue and demonstrate this nexus as it applies to their specific project.
- Why wasn't a rational analysis conducted comparing the benefits of a public infrastructure project to the proposed program? At this stage, staff is recommending a consistent and logical process that will yield sound investment decisions on a range of projects and enterprises. At later stages when specific projects are proposed, this comparative economic analysis will be conducted. For example, the Investment Fund program is designed to provide funding for infrastructure projects. At the time an infrastructure project is proposed, the benefits of the project will be objectively evaluated and compared to other competing investments. This evaluation may include a determination that the project offers such extraordinary benefits in comparison to possible benefits from Revolving Loan Fund and Grant Fund projects that the cap for infrastructure projects should be waived. An attempt to compare the benefits of a hypothetical infrastructure project with the hypothetical benefits of the Revolving Loan Program, other investments of the Investment Fund and the Grant program at this point would be arbitrary. Staff recognizes that money invested in a financial instrument that simply generates interest does not represent "working capital" to the Humboldt County economy. Staff feels that the benefits of diversification and maximization of long-term opportunity outweigh this disadvantage of structuring a portion of the Headwaters Fund as an endowment.
- Should the grant program be directed towards a limited number of select initiatives or a large number of varied small projects? This is a strategic issue that should be evaluated by the Headwaters Fund Board. The chosen strategy can be reflected in the final project selection and ranking criteria.

Staff thanks everyone that took the time to provide input on the Discussion Draft.

SECTION 4: FUND ALTERNATIVES

Based on the public input, alternatives for the management and use of the funds were grouped under six categories. Under each category a range of alternatives is presented for Board of Supervisor consideration. Each alternative has different implications for the effect of the fund in our community. The six categories are:

- **Goals**
- **Control and Oversight**
- **Staffing**
- **Financial Management**
- **Community Investment Opportunities**
- **Name**

For each category, we define the category, ask key questions that bear on the choices, present a range of alternatives and provide a staff recommendation and discussion. **Bold** lettering denotes staff recommendations. In Section 6, the staff recommendations are compiled into a draft proposed Charter for the Headwaters Fund.

GOALS

While the list of ideas for use of these funds is endless, everyone agrees that the fund should have clear goals.

Key Questions:

- What are we trying to achieve as a community with these funds?
- Should we target funding for specific projects? Or should we define clear, overarching goals, under which many varied projects may qualify overtime?

Alternatives:

G1 – Support the growth of base industry clusters and increase the number of long-term jobs that pay near or above the median income using values, principles and strategies outlined in the County’s Comprehensive Economic Development Strategy – currently called: “Prosperity! The North Coast Strategy.”

G2 – Enhance the quality of life through social and environmental projects that promote healthy communities and protect and enhance the natural environment consistent with the County’s Comprehensive Economic Development Strategy – currently called: “Prosperity! The North Coast Strategy.”

G3 – Fund the specific objectives of the July 8, 1997 Memorandum of Understanding between City of Eureka, County of Humboldt, Humboldt Bay Water District Humboldt bay Harbor, Recreation and Conservation District and the Northwestern Pacific Railroad (i.e., 1) Construct marine terminal, rail and highway improvements, 2) Fund watershed rehabilitation and maintenance of water quality

program, 3) Fund projects contained within the County Comprehensive Economic Development Strategy and the Harbor Districts Capital Improvement Plan, 4) Offset lost timber tax revenue, 5) Establish job retraining programs.)

G4 – Fund specific nominated projects (e.g., Humboldt Botanical Gardens, Tooby Ranch Park, Annie and Mary Railroad to Trail Conversion, Samoa Industrial Park, Humboldt County Watershed Improvement Program).

G5 – Fund specific community goals (e.g., resource protection, housing, substance abuse prevention, public transportation, community appearance, elderly care, education and training).

G6 – Fund based on geographic or jurisdictional boundaries (e.g., rural communities, south/north County, Cities, Special Districts).

Basis for Staff Recommendation on GOALS:

Public sentiment supported investments that would stimulate the local economy and grow the number of family wage jobs. This input reinforces similar input received by businesses, civic organizations and the public during the development of the County Comprehensive Economic Development Strategy - Prosperity! The North Coast Strategy (see Appendix VI for a description of Prosperity!).

Community comments did not express strong, broad-based support for any one project or set of projects, but there is clear, consistent support for lifting constraints on local businesses and capitalizing on private business opportunities. The goals and strategies of Prosperity! are intended to achieve this end. Prosperity! recognizes that one of Humboldt's most significant business asset is the quality of our communities and environment. Surveys conducted during the creation of Prosperity! indicate that business owners want to maintain their businesses in Humboldt County more for the quality of our community and environment than for economic advantage. Aligning the investment of these funds with the principles of Prosperity! allows the community to put its money where its values are, and to spread the investment across a diversity of economic, community and environmental projects, all of which will ultimately benefit the economy.

Prosperity! has been adopted by the County of Humboldt and numerous other jurisdictions and organizations. Many people cited Prosperity! as a significant asset because it represents a comprehensive and coordinated approach to community development that enjoys the support of a wide cross-section of the community. It is periodically updated to reflect current conditions and needs in the County. In the most recent update, hundreds of local businesses, organizations and residents contributed to the final report. Staff recommends that the final Headwaters Fund Charter include specifications for an inclusive public process to be used for all future updates of the County's Comprehensive Economic Development Strategy.

People expressed a desire to have clear, over-arching goals to guide the investment of funds over time as valuable private and public development opportunities present

themselves. This approach does not limit investment on MOU objectives, specific nominated projects, community goals, or geographic areas. Investment opportunities would be evaluated on an objective and equal basis for their ability to create high-quality jobs or to measurably advance our quality of life.

CONTROL and OVERSIGHT

Control and oversight carries many implications including spending priorities, access to capital, level of bureaucracy, community participation and flexibility of the fund.

Key Questions:

- Who should control the money and determine which projects and programs are funded?
- How is fiscal integrity and public accountability maintained?
- How will community values be represented in the day-to-day management and in the long-term direction of Headwaters Funds?
- What are the opportunities for community involvement?

Alternatives:

CO1 – Consider the funds available for general purpose County government spending under the direction of the Board of Supervisors. Funds would be allocated through the County budgeting process consistent with County government spending priorities; for example, road maintenance, sheriff protection or parks.

CO2 – Distribute the funds to jurisdictions and special districts within the County according to a specified formula, such as the Timber Yield Tax allocation.

CO3 – Grant the funds to a private, non-profit organization or foundation to manage and administer according to a specified Charter.

CO4 – Maintain Board of Supervisors control of the funds. Appoint a volunteer citizen board to review and recommend projects according to a specified Charter. Provide staff support to the committee through the County Economic Development Division.

Basis for Staff Recommendation on CONTROL and OVERSIGHT:

There was some support for a limited contribution to essential County services, but the overwhelming majority of input discouraged County use of the funds for general purpose spending. This input applied equally to the County and other government bodies that might use the funds simply to supplement existing revenue streams.

Most felt that the funds would not have a discernible impact in the community if they were co-mingled with government funds. Another practical concern is the affect of these funds on the ability of the County to participate in low-cost government borrowing programs. Every year the County must borrow money to meet short-term cash needs. If

the County has large cash reserves on hand, it cannot borrow at discounted rates through Tax and Revenue Anticipation Notes (TRANS). This increased the cost of borrowing by over \$100,000 during fiscal year 2000-2001. Fully segregating the Headwaters Funds from operational budgets and purposes eliminates this potential

Staff recommends one exception to the use of funds for general purpose spending. A portion of the Funds has been and should continue to be used to backfill the direct loss of Timber Yield Tax (see Appendix VII for an estimate of losses). The Board of Supervisors will set the appropriate amount for tax loss compensation.

Granting the funds to a non-profit organization or foundation would require mechanisms to regulate the long-term use of the funds and ensure public involvement and accountability.

Staff recommends Board of Supervisor maintain oversight of the funds with an enforceable provision preventing the use of the funds for general purpose spending. A volunteer community advisory board would make funding recommendations and popularly elected Board of Supervisor members would make final decisions and provide program oversight. This hybrid option would maximize community participation and accountability while protecting the funds from being absorbed in general purpose spending pools.

An irrevocable charter would ensure the funds are not used for general-purpose government spending but are targeted for distinct community priorities. The County's access to low-cost borrowing programs would be preserved (see Appendix VIII for more details).

STAFFING

The citizens committee and the Board of Supervisors will require staff support. The administration of the program will require individuals with skills in grant management, research, economic and community development, accounting and public processes.

Key Questions:

- Who should interface with the public, process applications and support committee and Board decisionmaking?
- What is the cost of maintaining staff support?
- How can public accountability and trust in the process be maximized?

Alternatives:

S1 – Contract with an existing non-profit organization, economic development agency or foundation.

S2 – Contract with a consultant.

S3 – Create a new office within the County.

S4 – Provide staff support through the County Community Development Services Economic Development Division.

Basis for Staff Recommendation on STAFFING:

The Economic Division is responsible for economic development planning and implementation, including grant management, community outreach and technical services to businesses and organizations. These capabilities and scope of work are a good match for activities of the Headwaters Fund. Complimentary operations will increase efficiency, cost effectiveness and the depth and breadth of staff support. In addition the Department is accountable to the Board of Supervisors and the public through well established systems of oversight.

Contract operation would distance fund decisionmaking from governmental operations and priorities. Without specific mechanisms for coordination, the program could suffer from a lack of integration with County economic development efforts.

FINANCIAL MANAGEMENT

The funds are currently deposited in the County Treasury and are being managed by the County Treasurer/Tax Collector. The principal and any accumulated interest throughout the life of the funds must be managed using standard investment analysis criteria, such as risk tolerance, return goals, liquidity, etc. In addition, the legal requirements imposed upon the investment of public funds by state and federal law must be followed.

Key Questions:

- What are the investment opportunities?
- What investment restrictions apply to the funds?
- How will investment choices be made?
- Are there differences in cost, risk and return of different investment managers?

Alternatives:

FM1 – Treasurer/Tax Collector invests the Headwaters fund principal as a part of the County treasury.

FM2 – Professional Fund Manager, chosen by Request for Proposals process, advises the Treasurer/Tax Collector on Headwaters fund investment management.

FM3 – Commercial Bank, chosen by Request for Proposals process, guarantees principal and provides a fixed rate of return.

FM4 – Endowment fund investment specialist, chosen by Request for Proposals process, pools funds with similar funds that have both long- and short-term goals.

Basis for Staff Recommendation on FINANCIAL MANAGMENT:

Staff recommends that the Treasurer/Tax Collector manage the Headwaters principal as a

separate fund in the County Treasury. This investment pool contains \$175 million and has achieved an annual rate of return in excess of 5%. The advantage of this approach is the liquidity that is provided for the funds even though most of the funds can be fully invested.

Additionally, public funds in reserve for future use are strictly regulated by California State Code. In general these investments are limited to U.S. Treasury notes, other government agency notes and corporate notes rated A or better. The Treasurer/Tax Collector is an expert in California and federal public finance restrictions.

Research for this project included a review of other economic adjustment funding pools in California (see Appendix IX). In the cases researched involving County funds, the Treasurer/Tax Collector managed investment of the principal.

An investment advisor could be hired as necessary to review the investment of the principal and the overall community investment strategy of the Fund. There may be higher interest opportunities for the principal than standard County treasury investments. Much of the funds will be invested in Humboldt County through various instruments including local loan programs, endowments and grants. Given that these community investments will have multiple and different return goals and liquidity needs, the overall investment strategy will require active management. This specialist could advise the community advisory board and the Board of Supervisors on portfolio design and diversification employing principles of asset management (see Appendix X for a review of relevant asset management definitions and concepts).

COMMUNITY INVESTMENT OPPORTUNITIES

Headwaters funds could be invested in the community through loans, grants, endowments, construction of infrastructure, government services and purchases of land.

Key Questions:

- What investment opportunities provide the greatest potential for achieving the goals of the fund?
- Where are the most significant gaps in existing resources in our community?
- Can the Headwaters funds leverage additional loan or grant funds?
- Can the investments be designed to complement, rather than compete with, existing local resources?
- Can the funds be invested so that they continue working in the community in perpetuity?
- Should the funds be used for government operations and programs?

Alternatives:

CIO1 – Loans that provide gap financing not currently available, in a structure that returns both principal and interest to the fund.

CIO2 – Grants to community groups for local projects.

CIO3 – Investments that continue to work in the community over time.

CIO4 – Infrastructure that enhances our economy, environment or social conditions.

CIO5 – General-purpose government spending.

Basis for Staff Recommendation on COMMUNITY INVESTMENT OPPORTUNITIES:

Staff recommends designing the Headwaters Fund to have the flexibility to utilize all of these instruments to maximize investments in the local economy while preserving the majority of Headwaters Fund principal. Staff recommends that the funds be divided into three categories: (1) a Revolving Loan Fund, for businesses and organizations, (2) an Investment Fund, to provide capital for infrastructure, endowment programs and revolving loan programs on a cash match basis; and (3) a Grant Fund, using interest from the principal to fund project grants on an annual basis.

Money not committed to these funds would be maintained in a Liquidity Fund for the sole purpose of generating interest. While staff does not recommend the funds be used for regular government spending, there may be distinct projects or programs that government is best suited to carry out, and in those cases should be able to apply for Headwaters Funds subject to the same criteria as all other applicants.

Staff supports the public's desire to protect the principal to the greatest extent possible. Reasons to preserve the principal include:

- No large capital intensive project currently enjoys widespread support or offers the promise of immediate and verifiable job growth and economic benefits.
- The Headwaters Fund is small relative to the cost of some large-scale proposed projects such as rail line rehabilitation, public marine terminal construction and the airport runway extension.
- Diversifying investments over time periods and projects can minimize risks.
- There is a limit to the number of high-quality investment opportunities at any particular time.
- The investment climate will change in the future and may provide better opportunities at a later date.
- The community derives satisfaction from having a pool of funds available to capitalize on future opportunities. The presence of the funds alone can promote a culture of development and opportunity.
- The nest egg is a way for the current generation to pass-on something of value.

The disadvantage of preserving the principal in out-of-County investments is the money does not create benefits to the County except in the interest earned. The Revolving Loan Fund is intended to preserve principal and invest in the local economy. Investments from the Investment Fund will reduce Headwaters Fund principal but are intended to seed community programs that can become self-sustaining or infrastructure projects that create

on-going benefits. These funds, in combination with the Liquidity Fund and Grant Fund, are intended to optimize the preservation of capital and active investments in the community.

Staff also supports the public desire to be conservative with the funds. Proposed matching fund requirements and evaluation criteria are intended to ensure the funds have the greatest possible impact and go to the most deserving and worthwhile projects. The Board of Supervisors and the community advisory board could adjust these criteria at a later date if necessary to increase the number of funded projects.

To obtain maximum effect, investments will be complimentary to existing programs and strengthen the local system of economic and community development (see Appendix XI for a review of potential funding and implementation partners). For example, small business support programs could increase the number of local businesses taking advantage of the Revolving Loan Fund over time.

NAME

To date the funds have been popularly known as the “Headwaters Funds.” The Board of Supervisors can choose any name that best serves the long-term purposes of the fund.

Key Questions:

- Should the name reflect the origin of the monies or the purpose of the fund?
- How should a name be chosen?

Alternatives:

The following names are candidates:

N1 – Headwaters Fund

N2 – Headwaters Mitigation Fund

N3 – Headwaters Economic Development Fund

N4 – Headwaters Economic and Community Development Fund

N5 – Headwaters Community Investment Fund

N6 – Headwaters Fund

N6 – Prosperity Community Investment Fund

N7 – Humboldt Investment Fund

N8 – Other Name

Basis for Staff Recommendation on NAME:

Based on the public input provided during the December 11, 2001, Headwaters Report Discussion Draft workshop, it appears the majority of the interested public would prefer the Fund to retain the name that it has already assumed. Staff can support this position, although it is contrary to the original staff recommendation of “Prosperity” Fund, named to reflect the fund’s forward-looking purpose. While the public acquisition of the Headwaters Forest was controversial, it is a part of our common history and perhaps should live on in name through the Fund.

SECTION 5: PROPOSED CHARTER

NAME

Headwaters Fund

GOALS

Use the values, principles and strategies of the County's Comprehensive Economic Development Strategy, currently known as Prosperity! The North Coast Strategy to:

- Support the growth of base industry clusters and increase the number of sustainable jobs that pay near or above the median income.
- Enhance the quality of life through social and environmental projects that promote healthy communities and protect and enhance the natural environment.

Manage the program to:

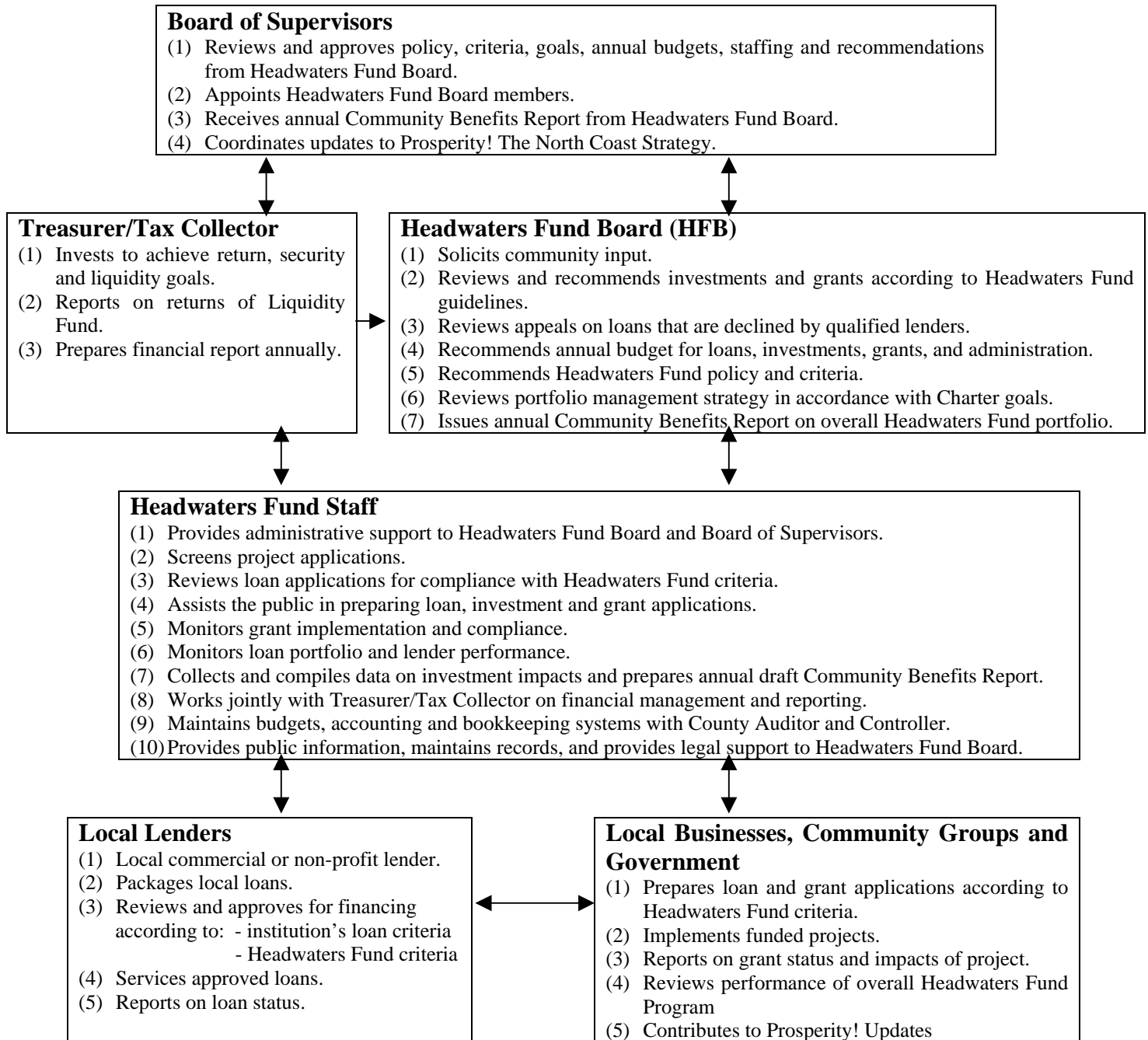
- Attract and leverage additional capital and grants in the local economy.
- Keep the funds working in the community in perpetuity.
- Reflect community priorities and create maximum public benefit over the long-term.
- Make the decision process objective, non-political and easy for the public to participate in and understand.
- Manage the funds efficiently and cost effectively.
- Track and publicize the economic, social and environmental gains.

CONTROL AND OVERSIGHT

The Board of Supervisors ultimately controls the funds. A Headwaters Fund Board, County Economic Division staff and the Treasurer/Tax Collector implement the program. Applications for funding from local businesses, community groups and governmental organizations are brought to the Headwaters Fund Board. Figure 1 is an organization chart outlining roles and responsibilities.

Headwaters Funds are segregated from the General Fund and budget of the County. The funds are irrevocably committed to the Headwaters Fund and cannot be used for financing on-going government operations. For purposes of IRS requirements, the funds are considered "un-available" to the County for general purpose spending or working capital, even during times of fiscal emergencies.

Figure 1. Headwaters Fund Organization Chart



The Board of Supervisors – has the final authority and accountability for the use of the funds. They appoint members to the Headwaters Fund Board and oversee County staff support. They review and approve Headwaters Fund Board funding recommendations. The Board provides oversight of the process focusing on the following issues:

- Adherence to the Headwaters Fund Charter

- Public involvement and reporting
- Objective implementation of the grant approval process.
- Proper financial management of the Liquidity Fund, Revolving Loan Funds and Investment Funds
- Periodic update and revisions to the Charter

The Headwaters Fund Board (HFB) – makes determinations on grant applications and hears appeals on loans that have been declined by lending institutions. The HFB consists of 9 members of the community nominated by peers and appointed by the Board of Supervisors. The distinguishing characteristic of a member should be a history and an ability to advance the interest of the community as a whole. Members should be selected from a reasonable cross-section of the community but should not be expected to represent the special interest of a group or sector. People with experience in the following areas should be considered.

- environmental affairs
- social welfare
- rural development
- governmental operations
- industry clusters
- banking and finance
- non-profit administration
- public interest
- economic development

In addition to application review and approval, the HFB oversees policies of the program. The HFB will present an annual Community Benefits Report to the Board of Supervisors in a public forum. The report will summarize chosen projects of the Headwaters Fund and their benefits to the community. The report will include a financial summary of fund balances, expenditures, and revenues and a profile of significant community outreach, public participation and application processing activities.

The HFB will be provided with staff support and an annual budget for technical or financial consulting to assist in application analysis and review. They will also make recommendations to the Board of Supervisors for updates, revisions and variances to the Headwaters Fund Charter.

Treasurer/Tax Collector – manages the Headwaters Liquidity Fund. This fund contains the primary principal. Disbursements are made from this fund to the Revolving Loan Fund, Investment Fund and Grant Fund as funding applications are approved. The Treasure/Tax Collector must abide by public investment and Headwaters Fund guidelines and periodically report financial activity.

Headwaters Fund Staff –consists of the Director of Community Development Services, and staff of the Economic Development Division. The staff implements the Headwaters Fund program from development and administration of systems, to program evaluation

and reporting. Staff shall consist of a full-time Economic Development Specialist, supported by a one-half time Administrative Secretary. This will require additions to existing staffing in the Division. Legal support will come from the Deputy County Counsel assigned to Community Development Services. Staff will be ultimately responsible to the Board of Supervisors for meeting Headwaters Fund and Headwaters Fund Board expectations.

Local Lenders – package and underwrite loans made through the Headwaters Revolving Loan Fund. A local lender applies to the HFB for access to Headwaters Revolving Loan Funds. Loan products, terms, audit provision and reporting are specified by contract. Contracts are renewed on an annual basis. The financial institution’s past performance in servicing the loan and reporting to the PF in prior years will be considered evaluation for future loans.

Revolving Loan Fund applicants apply directly to these local lenders for funding. The local lenders evaluate and approve the loan package according to their criteria and Headwaters Fund criteria. Declines for funding by the local lender are appealed to the HFB. The local lender must semi-annually report lending activity and performance to the HFB.

Local Businesses, Community Groups and Government - prepare loan and grant applications consistent with Headwaters Fund criteria and implement Headwaters Fund projects under contract with qualified lending institutions or the County. These interests must also be involved in Prosperity! updates and periodic review of the Headwaters Fund program.

FINANCIAL MANAGEMENT

The Humboldt County Treasurer’s Investment Pool acts as bank for the funds that are not committed to loans or grants. Funds in this “Headwaters Liquidity Fund” are invested by the Treasurer/Tax Collector for return, security and liquidity. While money in the Liquidity Fund will provide interest, the principal will not be “working” within the community.

Investments in the community will be made from the Liquidity Fund in three categories:

- 1) **Revolving Loan Fund** – primarily intended for loans to business for expansion and job creation.
- 2) **Investment Fund** – provides grants for community endowments, revolving loan programs and permanent infrastructure projects.
- 3) **Grant Fund** – provides pre-grant project development funds and cash match for grant applications to foundations and state and federal agencies.

An overview of the guidelines and restrictions for each investment category are described in the next section.

The management objective is to maximize the amount of money working within the community providing desired benefits while preserving the Headwaters Fund principal.

REVISIONS, AMENDMENTS AND VARIANCES

The Charter shall be subject to a comprehensive review after the first full year of operation and once every three years thereafter. The review will include an evaluation of the Fund's effectiveness and recommendations for revisions or amendments. The public and participants in Fund activities will be given an opportunity to provide comment and participate in the drafting of the review. The review will be prepared by staff and incorporated in the annual Community Benefits Report. The report will be reviewed and approved by the Headwaters Fund Board and forwarded, with recommendations, to the Board of Supervisors. The following aspects of the Charter shall be subject to change through the comprehensive review process:

- Goals
- Size and composition of Headwaters Fund Board members
- Liquidity Fund investment guidelines
- Staffing and administration
- Public involvement and reporting processes
- Allocation of money between funds (Liquidity, Revolving Loan Fund, Investment Fund and Grant Fund)
- Project funding caps and match requirements
- Project acceptance and ranking criteria

Variations to Charter guidelines can be granted for specific projects under select circumstances where it can be shown that the variance will further the ultimate goals of the Fund. To qualify for a variance, a project must provide extraordinary benefits in line with the appropriate ranking criteria. For example, an infrastructure project that would create an extremely high number of jobs with a cash match ratio of one Headwaters Fund dollar to twenty project dollars could be a justification for granting an increase in the spending limits of the Investment Fund. Variance applications would accompany project funding applications and would ultimately be approved by the Board of Supervisors by a four-fifths super-majority vote.

COMMUNITY INVESTMENT OPPORTUNITIES

Headwaters Fund will make community investments in three categories: (1) Revolving Loan Fund; (2) Investment Fund; and (3) Grant Fund. The Investment Fund and Grant Fund are both grant programs but have different criteria. The guidelines are summarized below. These guidelines will be reviewed by the Board of Supervisors and refined as opportunities and market demand become better known.

Figure 2. Community Investment Opportunities

<p>Revolving Loan Fund (RLF)</p> <p>Target approximately \$8 M – Work to place up to \$2 M per year in the first five years and more if possible thereafter.</p> <ul style="list-style-type: none"> - Revolves in perpetuity. - Managed with earnings of loans. - Returns approximately 6% net annually. - Loans approved by local lenders. - Reports semi-annually. - All projects identified as Headwaters Fund investments. <p><i>Eligible Business Uses:</i></p> <ul style="list-style-type: none"> - Working capital. - Real estate development. - Loan guarantees. - Equipment purchases. - Product research & development. <p><i>Eligible Non-profit Uses:</i></p> <ul style="list-style-type: none"> - Bridge loans for land trust purchase. - Cash flow loans on approved grant. - Real estate purchase or renovation. - Infrastructure improvements. <p><i>Potential Impacts:</i></p> <ul style="list-style-type: none"> - Long-term job growth. - Increase in amount of industrial land. - Business growth. - Diversification of the economy. - Increased stability of local employers, both for-profit and not-for-profit. - Wide range of leaders implementing Prosperity! - Increased capital flow into local economy. - Residents see and feel the impact of Headwaters Fund. 	<p>Investment Fund</p> <p>Maximum \$5M – up to \$1M per project.</p> <ul style="list-style-type: none"> - Seeds programs that continue to revolve financially and provide services in the community. - Leverages substantial capital into the economy. - Applicant must provide the majority of funds (> 50% or 75%) from other sources. - Reports annually. - All projects identified as Headwaters Fund investments. - Applicant must prove no other funding available. <p><i>Eligible Applicants:</i></p> <ul style="list-style-type: none"> - Government jurisdictions - Non-profit public benefit corporations <p><i>Eligible Uses:</i></p> <ul style="list-style-type: none"> - Cash match for endowment funds. - Cash match to grants that create revolving loan funds. - Infrastructure projects that benefit base industry clusters. <p><i>Potential Impacts:</i></p> <ul style="list-style-type: none"> - Long-term job growth. - Increased capital flow into local economy. - Diversity of needs addressed. - Wide range of leaders implementing Prosperity! - Residents see and feel permanent impact of Headwaters Fund. - Enhanced quality of life. 	<p>Grant Fund</p> <p>Annual interest earnings budget –estimated at approximately \$400,000 per year</p> <ul style="list-style-type: none"> - Funds community projects on a cash match basis – provides up to 50% match. - Averages 12 grants at \$10K to \$100k per grant annually. - Provides mini-grants (2 per cycle - up to \$10,000 each) for pre-grant application project development. - Grants for technical assistance to Revolving Loan Fund loan recipients - Projects report quarterly and annually. <p><i>Eligible Applicants:</i></p> <ul style="list-style-type: none"> - Non-profit public benefit corporations. - Government jurisdictions. <p><i>Eligible Uses:</i></p> <ul style="list-style-type: none"> - Local grant funded projects that forward the goals of Prosperity! <p><i>Potential Impacts:</i></p> <ul style="list-style-type: none"> - Diversity of needs addressed. - Short-term job growth. - Increased grant contributions to the local community from other sources. - Wide range of leaders implementing Prosperity! - Enhanced quality of life through increases in social and environmental capital.
--	--	---

REVOLVING LOAN FUND

Investments in business expansion will be made through a series of revolving loan funds managed by local lending institutions, such as; Redwood Region Economic Development Commission, Arcata Economic Development Corporation and local community based banks. The Revolving Loan Fund would not create a new loan program and bureaucracy rather it make supplemental funding and loan products available to businesses through

existing local loan programs. Local loans programs would apply to the County to become a “Qualified Headwaters Fund Lender.” Once qualified and under contract, the local lender would underwrite and service the loans. These loans will include a range of products in order to provide capital to the widest range of businesses and to fill gaps in the market for available financing, while still maintaining good banking practices.

Based on market research there is a potential demand for the following loan products and capital:

- Working Capital loans: loans up to 7 years in amounts ranging from \$35,000 to \$200,000.
- Fixed Assets Loans: loans up to 15 years in amounts ranging from \$100,000 to \$1,000,000.
- Guaranteed Loans: any of the loans in the above categories could also include a guarantee backed by a reserve fund created from the earnings from the Headwaters Fund. A special reserve fund would be established from the earnings of the Headwaters Fund to cover a higher than normal loss rate for these loans.
- “Venture Capital” Loans: These products would represent debt to the receiving companies but would be designed with equity characteristics. Typical characteristics would include subordination to all other debt, deferred payments on principal and interest, long repayment terms and opportunities for the lender to receive royalty on profits, warrants to purchase equity and rights for conversion to equity. The County will enter into discussions with Qualified Lenders to create this range of loan products.

Note: “Venture Capital” loans occupy the middle ground in the business financing spectrum between “pure” equity on the one side and senior non-subordinated bank debt on the other. Community Development Venture Capital Funds in the United States place almost half of their investment in companies in the form of debt with equity characteristics. These loans represent a step towards venture capital for local businesses without the overhead of a venture capital program. For a complete discussion of this issue and staff recommendations to eventually develop access to “pure” equity for local businesses see Appendix XII.

Proposed terms and requirements for these “gap” loan products; including size of loans, interest rate, maximum terms, loan to value ratios, audits and reporting will be determined by the Board of Supervisors after discussions and negotiations with qualified lenders.

Each of these products will be available to private companies, public agencies, and public/private projects. These investments could encompass a wide range including: high tech start-ups, dairy farms, seismic retrofitting, environmental restoration companies and many others. Eligibility criteria will be developed in conjunction with qualified lenders.

In addition to standard underwriting criteria, applicants will have to demonstrate that the use of the money will further the goals of Prosperity!

It is anticipated that any project seeking financing will first apply to commercial lenders. If the project cannot be financed conventionally, it can then apply through qualified local lenders for one of the working capital or fixed asset loans. If the project is unable to meet the requirements of these loans, it is eligible to apply for the guaranteed loans.

All programs and projects funded by the Headwaters Fund will report the impacts of that investment at least annually for as long as the project or program operates, and will carry the logo or statement in their marketing materials.

INVESTMENT FUND

The Investment Fund is a grant program intended for projects that will result in permanent, tangible benefits to the community. Eligible endowments and revolving loan fund projects must demonstrate the ability to operate sustainable programs with the grant provided from the Investment Fund.

Endowments and revolving loan fund projects must obtain a minimum of 50% of the funding required from other sources. Infrastructure projects must obtain a minimum of 75% of the funding and demonstrate the value of the project to the growth of base industry clusters.

The term infrastructure refers to fundamental facilities or improvements that serve the local economy. Watershed restoration projects can be considered “infrastructure” in that they ultimately support the viability of the fisheries, lumber and tourism industry clusters. However, the economic contribution must be shown on a project-by-project basis using an economic analysis specific to the project.

Investment Fund preliminary applications are submitted to Headwaters Fund staff for screening against application acceptance criteria. Applicants who submit acceptable preliminary applications will be invited to complete a full application for ranking and consideration by the Headwaters Fund Board.

The Headwaters Fund Board will develop final application screening and project ranking and selection criteria for the Investment Fund within four months of the Fund’s inception. The preliminary criteria outlined below will form a starting point for the development of final criteria. The Board of Supervisors will ultimately approve the final criteria, after receiving public input and recommendations from the Headwaters Fund Board.

Preliminary Investment Fund Acceptance and Ranking Criteria:

- Acceptance Criteria
- Ranking Criteria
 - Overall Benefit

- Economics
- People and Community
- Environment
- Need
- Capacity and Organizational Strength
- Supplemental Criteria

Acceptance Criteria:

- Creates a sustainable revolving loan fund, or,
- Creates a sustainable endowment and attracts a minimum of 50% match, or,
- Creates infrastructure benefiting base industry clusters and attracts 75% match.

Ranking Criteria (total points possible 110):

Overall Benefit Economics, People and Community, Environment: (In the Overall Benefit category, the total maximum points that can be credited to a project is 60, out of a possible numerical score of 90. Points are assigned based on the magnitude of benefit.)

Economics (total possible 40): Points are assigned based on the direct effect the project has on the economy.

Creates or Retains Sustainable Jobs at or above Median Income Levels (30):

These are primary jobs employed by the project.

0		30
no jobs	large number of jobs with high cost/benefit factor	

Increases Amount of Goods and Services Produced (10): Measured as the gross sales revenue from goods and services produced over a ten-year period.

0		10
no increase in goods and services	large increase with high cost/benefit factor	

People and Community (total possible 25):

Enhances Infrastructure (15): Increases the standard of living or public health and welfare in the form of basic services (water, wastewater, roads, housing, telecommunications, etc.).

0		15
no improvements in infrastructure	large number of a target pop. served	

Creates/Improves Job Skills (10): Activities that increase the job skills for persons in Humboldt County will receive points.

0		10
no job training	high degree of job training	

Environment (total possible 25):

Land and Habitat Restoration (15): Activities that will have positive effect on the environment and long-term sustainability in the form of land restoration, pollution prevention, land conservation, increased bio-diversity and natural resource conservation.

0	15
no environmental benefit	high degree of sustainable benefit

Benefits the Environment (10): Activities that will have positive effect on the environment in the form of energy conservation or application of alternative energy, use of recycled materials, environmental education or other environmental enhancement.

0	10
no environmental benefit	high degree of sustainable benefit

Readiness (total possible 20):

For Projects:

Site-Control/Entitlements Received and Market/Engineering studies complete (10): Applicant has property access, required permits and approvals and has completed all feasibility studies demonstrating feasibility. Written program guidelines or project description will be evaluated to judge the likelihood that the program will achieve desired outcomes.

0	10
no approvals or studies	all approvals and studies complete

Fiscal Integrity (10): Fiscal integrity will be rated based on a project business plan and financial pro-forma and letters of commitment from cooperating entities.

0	10
low financial feasibility	high financial feasibility

For Programs:

Program Design and Effectiveness: (10) Written program guidelines will be evaluated to judge the likelihood that the program will achieve desired outcomes.

0	10
impractical	highly practical and effective

Fiscal Integrity (10): Fiscal integrity will be rated based on a program business plan and financial pro-forma and letters of commitment from cooperating entities.

0	10
low financial feasibility	high financial feasibility

Need and Cash Match (total possible 10):

Unmet Need and Sources of Funding (5): Does the program/project address an unmet need that cannot be funded through other sources.

0	5
redundant	unique approach or need unmet

Brings Capital Into the Community (5): Activities will be rated on cash match from outside sources. All projects meeting threshold match criteria receive 1 point. For each additional 10% increase in match an additional point is awarded.

1	5
no additional match	maximum match

Capacity and Organizational Strength (total possible 10):

Prior Experience Administering Similar Programs or Projects (5): Applicants will be rated on their history of administering projects or programs.

0	5
no experience	significant closely allied project or program experience

Capability (5): Applicants will be rated on their ability to administer the project or program based on skills, demonstrated support and strength of partners and depth of resources.

0	5
slight capability	highly capable

Supplemental Criteria (total possible 10): *(Note: These criteria would reflect annual priorities set by the Board of Supervisors through a public process. The criteria outlined below are examples of possible priorities.)*

Community (2): Criteria may include: Revitalizes community centers, utilizes existing buildings, fits with community image and identity, preserves heritage, etc.

0	2
no community benefit	enhances community

Environment (2): Criteria may include: Demonstrates good land use practices, conserves resources, enhances aesthetics, preserves open space, etc.

0	2
no environmental benefit	enhances environment

People (2): Criteria may include: Reduces poverty, addresses needs of family, youth, seniors, minorities, displaced workers of other target populations, etc.

0	2
does not benefit target populations	benefits target populations

Economy (2): Criteria may include: benefits local businesses, encourages entrepreneurship, increases global competitiveness, increases high wage jobs, benefits multiple industry clusters, increases tax revenues, etc.

0	2
no economic enhancement	significant economic enhancement

Government (2): Criteria may include: Contributes to multiple jurisdictions, promotes government excellence, accountability or efficiency, etc.

0	2
no government improvement	directly improves government

Applications to the Investment Fund are accepted on a semi-annual basis. Interim period applications can accepted if it can be demonstrated that delay will result in an irretrievably lost opportunity. There is no minimum annual allotment but a maximum annual allotment would be established. Projects approved for funding by the Headwaters Fund Board will be forwarded to the Board of Supervisors for review and approval.

GRANT FUND

Grant Fund preliminary applications are submitted to Headwaters Fund staff for screening. Applicants who submit preliminary applications that meet screening criteria will be invited to complete a full application for ranking and consideration by the Headwaters Fund Board.

The Headwaters Fund Board will develop final screening and project selection criteria for the Grant Fund within four months of the Fund's inception. The preliminary criteria outlined below will form a starting point for the development of final criteria. The Board of Supervisors will ultimately approve the final criteria, after receiving public input and recommendations from the Headwaters Fund Board.

Preliminary Grant Fund Acceptance and Ranking Criteria:

- Acceptance Criteria
- Ranking Criteria
 - ❑ Overall Benefit
 - Economics
 - People and Community
 - Environment
 - ❑ Need
 - ❑ Capacity and Organizational Strength
 - ❑ Supplemental Criteria

Acceptance Criteria:

- Attracts a minimum of 50% cash match, or,
- Is necessary to advance a project or proposal to enable acquisition of grants

Ranking Criteria (total points possible 110):

Overall Benefit: Environment, People, Community or Economic Advantage: (In the Overall Benefit category, the total maximum points that can be credited to a project is 60, out of maximum numerical score of 100. Points are assigned based on the magnitude of benefit.)

Environment (25): Activities that will have positive effect on the environment and long-term sustainability in the form of restoration, pollution prevention, land conservation, bio-diversity, resource conservation, application of alternative energy, use of recycled materials or other environmental enhancement.

0 **25**

no environmental benefit **high degree of sustainable benefit**

People (25): Reduces poverty, creates or improves job skills, builds leadership, increases recreation opportunities, addresses needs of family, youth, seniors, minorities, displaced workers of other target populations.

0 **25**

does not benefit target populations **large benefit to target populations**

Community (25): Revitalizes community centers, builds public infrastructure, improves public or pedestrian transportation, utilizes existing buildings, fits with community image and identity, preserves heritage.

0 **25**

no community benefit **significantly enhances community**

Economy (25): Benefits local businesses, creates or retains jobs, encourages entrepreneurship, increases global competitiveness, benefits multiple industry clusters, etc.

0 **25**

no economic enhancement **significant economic benefits**

Readiness (total possible 10):

Management and Effectiveness (5): Applicant has property access, required permits and approvals and has completed all feasibility studies demonstrating feasibility. Written program guidelines or project description will be evaluated to judge the likelihood that the program will achieve desired outcomes.

0 **5**

no approvals or studies **all approvals and studies complete**

Fiscal Integrity (5): The project budget will be evaluated for financial integrity, adequacy and commitments of financially cooperating entities.

0 **5**

low financial feasibility **high financial feasibility**

Need and Cash Match (10):

Unmet Need and Sources of Funding (5): Does the program/project address an unmet need that cannot be funded through other sources.

0 **5**

redundant **unique approach or need unmet**

Cash Match (5): Activities will be rated on cash match from outside sources. All projects meeting threshold match criteria receive 1 point. For each additional 10% increase in match an additional point is awarded.

1 **5**

no additional match **maximum match**

Capacity and Organizational Strength (10):

Prior Experience Administering Similar Programs or Projects (5): Applicants will be rated on their history of administering projects or programs.

0 **5**

no experience **significant closely allied project or program experience**

Capability (5): Applicants will be rated on their ability to administer the project or program based on skills, partnerships and depth of resources.

0 **5**

slight capability **highly capable**

Supplemental Criteria (total possible 10): *(Note: These criteria would reflect annual priorities set by the Board of Supervisors through a public process. The criteria outlined below are examples of possible priorities mentioned during public input.)*

Community (2): Develops rural areas, trails or information technology.

0 **2**

no benefit **significant benefit**

Environment (2): Watershed restoration, energy conservation or beach and dunes management.

0 **2**

no benefit **significant benefit**

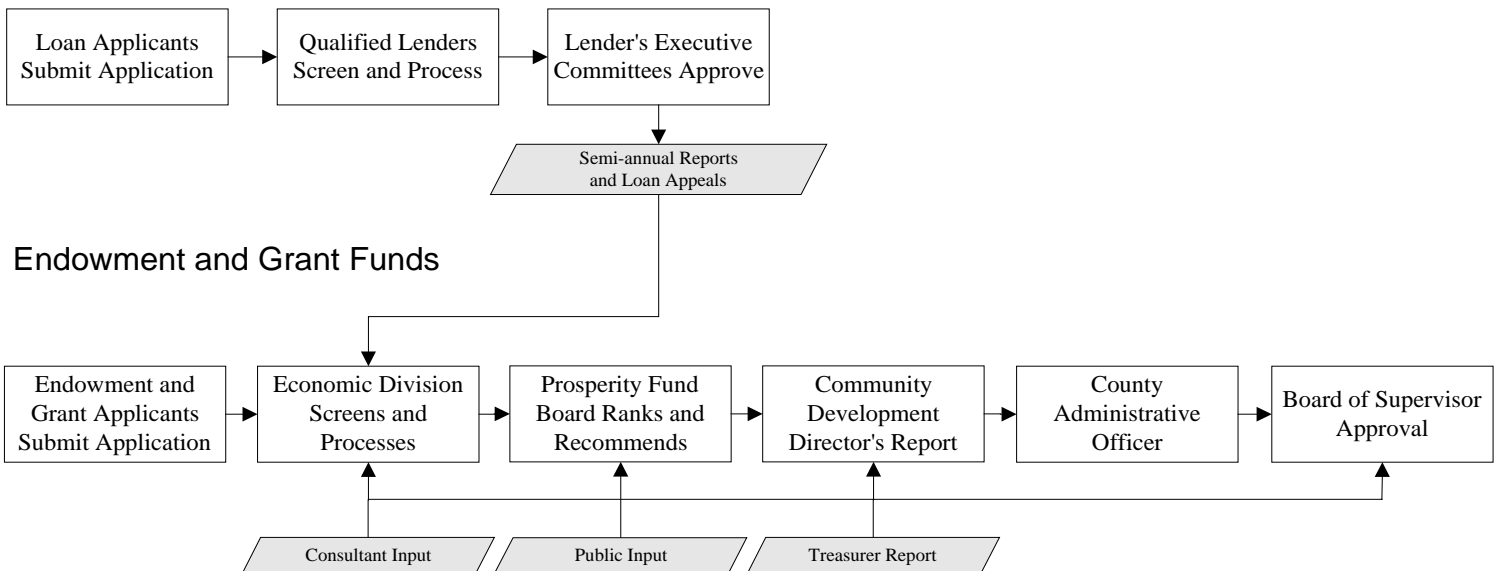
People (2): Assists Native American communities, youth or homeless.	2
0	2
does benefit target population	benefits target population
Economy (2): Benefits Manufacturing Cluster, redevelopment of industrial lands or agricultural land preservation.	2
0	2
no enhancement	significant enhancement
Government (2): Improves customer service, cooperation between jurisdictions or regulatory permitting processes.	2
0	2
no government improvement	significant improvement

Applications to the Grant Fund are accepted on a semi-annual basis. The Headwaters Fund Board will determine the annual maximum amount of funds available based on the interest earnings from the Liquidity and Revolving Loan Funds during the previous year. There is no minimum annual allotment. Projects approved for funding by the Headwaters Fund Board will be forwarded to the Board of Supervisors for review and approval.

Figure 3 maps the decisionmaking process for loan, investment and grant applications.

Figure 3 Decision Process For Prosperity Funds

Revolving Loan Fund



SECTION 6: ILLUSTRATIVE PORTFOLIO

The Board of Supervisors can adjust the allocation of money between the Liquidity, Revolving Loan, Investment and Grant Funds in response to opportunities and market demand. The target allocation outlined in the proposed Charter is a useful starting point to set the program in motion. What follows is an illustrative portfolio to better convey the implications of the target allocation in each investment category and their interaction.

Sources of Earnings

The basic assumptions that underlie the illustrative portfolio are summarized below.

The total amount invested in the Revolving Loan Fund over a period of five years is \$8,000,000. This will be broken down as shown in Table 1. The \$4.0 million amount for working capital is estimated to be the maximum that could reasonably be placed in these types of loans over a four to five year period, based on discussions with AEDC, RREDC and local banks. In addition, Table 2 shows an additional \$4.0 million in loans if new loan products are offered that can attract businesses that would not qualify for typical RLF loans. Net interest from the RLF will be available for the Grant Fund.

A maximum of \$5 million of the Liquidity Fund is reserved for allocations to the Investment Fund. Interest from this set-aside will accrue to the Investment Fund.

A total of \$10 million will remain in the Liquidity Reserves invested in the County Treasury. Interest from this principal will be available for the Grant Fund.

		Loss Rate	
		Over 10 Years	Annualized
Working capital loans	\$ 4,000,000	10.0%	1.0%
Fixed asset/real estate loans	1,750,000	10.0%	1.0%
Guaranteed loans	750,000	30.0%	3.0%
Venture loans	<u>1,500,000</u>	30.0%	3.0%
Total	<u>\$ 8,000,000</u>		

Source: Economic Division Staff and Williams-Kuebelbeck & Associates

Based on an estimated annual return of 10.0% for RLF Loans and 5.0% from investments in the Liquidity Fund (government notes), the total estimated annual gross earnings would be \$1.3 million. Estimated operating expenses for the RLF funds are estimated to be 20% of earnings. If normal loan losses are 10% of loan value, and guaranteed and

venture loans are 30% of loan value, then an annual reserve of 2.0% over ten years should be set. These two items combined would be \$320,000 and thus estimated annual net earnings would be \$980,000, or approximately 5.4% for the Liquidity Fund and Revolving Loan Fund overall.

Uses of Earnings

Table 2 also shows various anticipated uses for the earnings from the Revolving Loan and Liquidity Funds. These include:

- Timber Yield Tax Replacement - \$308,711 per year for an additional 13 year period. These funds would be partially used to fund the annual administrative cost of the Economic Development Division which for two years has been an expense to the Headwaters Fund (up to \$80,000 per year). This would leave a net annual contribution to the General Fund of \$228,711. The Board of Supervisors would review the level of contribution to the Economic Development Division annually.
- Reserve to add back to the principal to offset inflation – 1% of \$18 million or \$180,000 per year.
- A budget for consultants and staff (1.5 FTE) to the Headwaters Fund Board - \$115,000 per year. This budget will be overseen and capped by the Board of Supervisors on an annual basis.

These budget items for the first thirteen years are estimated to total \$603,711. Thus the net available for the Grant Fund will be \$376,289 annually.

The example shown in Table 2 assumes that a small amount of grant funds will be used to support technical assistance for recipients of RLF loans. Under this scenario there would be \$346,289 annually in net earnings available for non-loan related grants.

Table 2 does not include the \$5 million Investment Fund. Earnings to this fund would accrue to the Investment Fund and not be available for the Grant Fund.

Table 2
ILLUSTRATIVE SOURCE AND USE OF EARNINGS
(Year 5)

Source of Earnings	<u>RLF Funds</u>	<u>Liquidity Fund</u>	<u>Total</u>
Funding Level	\$8,000,000	\$10,000,00	\$18,000,000
Interest Rate	10.0%	5.0%	
Gross Return	800,000	500,000	1,300,000
Expenses			
Expenses (20%)	160,000	0	
Normal Loss Reserve (1)	<u>160,000</u>	0	
Total Expenses	<u>320,000</u>	<u>0</u>	<u>320,000</u>
Net Earnings	\$480,000	\$500,000	\$ 980,000
Net Earnings (% return)	6.0%	5.0%	5.4%
Uses of Earnings			
Timber Tax Replacement			\$308,711
Reserve for Inflation (2)			180,000
Headwaters Fund Consultants and Staff (1.5 FTE)			<u>115,000</u>
Subtotal			\$603,711
Net Available for:			
Direct Grants			\$346,289
RLF Technical Assistance Grants (3)			<u>30,000</u>
Total Grants			\$376,289

- (1) Reserve of 20% of principal equals 2.0% losses per annum over 10 years.
(2) At 1.0% on \$18 million per annum.
(3) Grant allocation to compliment the RLF program.

Source: County Staff and Williams-Kuebelbeck & Associates

There will be some start up expenses associated with setting up this organizational structure. Probably an amount in the range of \$80,000 will be needed to finalize program materials, agreements and establish reporting systems for the Headwaters Fund.

Ongoing Impacts

The portfolio allocation in Table 2 is based on Year 5 of operation of the Headwaters Fund. The fund will build up to these targets over the first five years of operation, although, if the level of local business activity increases it may be possible to shift even more money to the RLF.

For this scenario it is assumed that the fund will be stabilized, that is, approximately \$10 million will remain in the Liquidity Fund and as the \$8.0 million in the various RLF's is

repaid it will be used to make new loans. More than \$300,000 will be available for grants annually. More than \$600,000 will be available annually after the Timber Yield Tax payment expires.

The strict matching and performance criteria of the Investment Fund are designed to apply to limited high value opportunities. Because few projects will meet the Investment Fund criteria, it is anticipated that this Fund should last as much as 15 or more years. Due to the sustainable nature of projects eligible for the Investment Fund, the effects in the community should continue much longer.

This level of investment will have been accomplished while maintaining the bulk of the principal enabling the benefits to continue in perpetuity.